INTERIM AUDIT GUIDELINE

State of Washington Department of Revenue
REVENUE

Interim Audit Guidelines are interpretive statements issued by the Department of Revenue under authority of RCW 34.05.230. These guidelines explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts and are intended to communicate timely guidance of tax issues important to the public and agency staff where no published guidance exists. They are advisory for taxpayers; however, the Department is bound by these guidelines until superseded by Court action, Legislative action, rule adoption, or an amendment to or cancellation of the interim audit guideline.

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Interim Audit Guideline 04.01

Taxability of Investment Income

The purpose of this interim audit guideline is to provide guidance to Department personnel in the application of the business and occupation tax deduction provided in RCW 82.04.4281 for investment income of persons other than those engaging in "banking, loan, security, or other financial business."

The meaning of the term "financial business", as used in RCW 82.04.4281, has been the subject of disagreement between the Department and certain businesses that receive investment income. Several court decisions have articulated some broad guidelines and principles for interpretation of the language of RCW 82.04.4281, but these decisions have not provided the clarity and certainty desired by taxpayers and the Department. The most recent of these court decisions is *Simpson Investment Co. v. Department of Revenue*, 141 Wn.2d 139 (2000).

In response to these concerns about the application of RCW 82.04.4281, the Legislature enacted Sections 18 and 20 of House Bill 1361 (Chapter 320, Laws of 2001, effective July 1, 2001). Section 18 of the bill expresses the Legislature's intent to delay any change in the way the Department administers RCW 82.04.4281, as a result of the *Simpson Investment Co.* decision, until definitions or standards regarding the taxation of investment activity can be enacted by the Legislature. Section 20 of the bill directs the Department to work with members of the business community to propose amendments to RCW 82.04.4281 that will clarify the tax treatment of investment activities.

Consistent with the legislative intent expressed in Section 18 of House Bill 1361, Governor Locke has specifically instructed the Department not to change or expand its interpretation of RCW 82.04.4281 as a result of the *Simpson Investment Co.* decision. The Governor's instructions make clear that the Department is to apply pre-*Simpson Investment Co.* policies and interpretations with respect to RCW 82.04.4281.

Accordingly, when conducting examinations of taxpayer records auditors are not to assert business and occupation tax on the investment income of any business that is different in character from other businesses that have previously been subject to tax on their investment income. The following procedures are to be followed in any situation where an auditor is considering asserting tax on unreported investment income the auditor believes was incorrectly deducted in computing tax. Prior to raising the issue with the taxpayer, the auditor is to discuss the possibility of assessment with his or her field audit manager. Where it is not absolutely clear under Department policies and interpretations existing prior to the *Simpson Investment Co.* decision that the type of business in question would be subject to tax as a “financial business”, the matter is to be referred through field audit management to the appropriate regional audit manager prior to taking any action. The regional audit manager, in consultation with the Assistant Director of the Audit Division, will then make a determination whether asserting tax on the investment income in question is consistent with the legislative intent expressed in Section 18 of House Bill 1361 and the Governor’s instructions.